

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Gregory Scott
Marshall Johnson
LeRoy Koppendrayer
Phyllis A. Reha

Chair
Commissioner
Commissioner
Commissioner

In the Matter of Minnesota Power's Petition for
Approval of an Affiliated Interest Agreement
between Rainy River Energy Corporation and
Split Rock Energy, LLC

ISSUE DATE: November 13, 2002

DOCKET NO. E-015/AI-02-923

ORDER APPROVING AGREEMENT

PROCEDURAL HISTORY

On June 4, 2002, Minnesota Power (MP) filed a petition for approval of an affiliated interest agreement between Rainy River Energy Corporation (Rainy River) and Split Rock Energy, LLC (Split Rock). The agreement provides that Split Rock will provide power brokering services to Rainy River to facilitate Rainy River's resale, on the wholesale market, of energy from LS Power's (now NRG's) generating station in Kendall County, Illinois.

On August 16, 2002, the Department of Commerce (DOC) filed comments recommending approval with conditions and recommendations and expressed its concern with MP's intent to transfer, at some time in the future, non-regulated assets into MP, a regulated utility.

On August 29, 2002, MP filed reply comments agreeing to the modifications proposed by the DOC.

This matter came before the Commission on October 24, 2002.

FINDINGS AND CONCLUSIONS

I. The Legal Standard

Transactions between public utilities and their affiliates are governed by Minn. Stat. § 216B.48 and Minn. Rules, parts 7825.1900-7825.2300.

Minnesota Statutes § 216B.48, subd. 3 states in part:

...The commission shall approve the contract or arrangement made or entered into ... only if it clearly appears and is established upon investigation that it is reasonable and consistent with the public interest.

II. The Agreement

MP requests approval for an affiliated interest agreement between Rainy River and Split Rock that would enable Split Rock to act as a broker involved in Rainy River's power and energy marketing/trading of wholesale electric power and energy.

Rainy River is a second-tier subsidiary of MP and was organized to engage in marketing electric power and energy. Rainy River has a 275MW long-term power purchase agreement from LS Power's (now NRG's) 1100 MW natural gas-fired combined cycle generating station in Kendall County, Illinois. Rainy River requires power brokering services to facilitate the resale of this energy on the wholesale market.

Split Rock is a limited liability company, 50% owned by MP and 50% owned by Great River Energy, formed for the purpose of combining power supply assets and customer load service requirements for power pool operations. Split Rock provides exclusive generation control and load dispatching services to MP and Great River Energy and may also provide brokering services to third parties.

MPEX, which was a division of MP, had previously provided risk management, economic dispatch and power trading services to Split Rock. These MPEX employees had provided limited power brokering services to Rainy River.¹ On May 4, 2002, MPEX personnel became Split Rock employees, and certain services provided by MPEX personnel to other segments of MP's operation ceased at that time.

The petition by MP stated that the agreement between Rainy River and Split Rock will be in effect for only a short time because MP intends to acquire Rainy River's interest in the 275 MW power purchase agreement from the Kendall County unit.

III. Position of the DOC

The DOC objected to the agreement between Rainy River and Split Rock being characterized as an administrative service agreement. It stated that the intent of an administrative service agreement was to provide integrated services such as record keeping, financial reporting, tax, legal and corporate support function that are usually not cost effective to bid out. The DOC argued that under the present agreement Split Rock will provide to Rainy River power brokering, including transmission delivery, and such an arrangement should be considered a power brokering agreement.

The DOC also argued that the language of the agreement did not reflect that Rainy River will be charged the higher of fully allocated costs or market prices. The DOC recommended that the language in the agreement be changed to specifically reflect this. It also recommended that MP maintain adequate records to support that the higher of cost or market was appropriately charged to Rainy River, for purposes of a future rate proceeding.

The DOC was concerned about MP transferring non-regulated assets into MP, a regulated utility.

¹ Pursuant to the Minnesota Power - Rainy River Energy Corporation Administrative Services Agreement approved by the Commission on November 30, 1989 in Docket E-015/M-89-684 and updated in Docket E015/AI-97-1667, approved by the Commission on January 9, 1998.

This would be the case if MP acquired the Kendall County purchase agreement from Rainy River, as MP stated in the filing. The DOC recommended that the Commission address this matter now to ensure that nonregulated assets are not transferred from the non-regulated subsidiary (that they currently reside in) to MP, the regulated entity.

The DOC stated that without a showing of substantial benefits to the regulated system from transferring unregulated assets to be held as such within the regulated company, the unregulated assets should remain in a separate subsidiary to preserve the protections offered by the FERC standards of conduct and to maintain less complicated accounting procedures.

The DOC stated it could agree that the affiliated interest agreement addressed in this filing was in the public interest if MP incorporated language into the agreement requiring the higher of fully allocated costs or market prices. Additionally, the DOC considered it unreasonable to move the purchase agreement for the Kendall County generating unit into the MP regulated utility and in essence recommended that MP not pursue the transfer.

IV. Position of MP

MP indicated that the agreement was in the public interest for the following reasons:

- the agreement ensures that proper accounting procedures are in place to compensate Split Rock for services provided to Rainy River;
- the marketing of Split Rock can continue until such time as the power purchase agreement is transferred to MP;
- the protections in place under Rainy River's market based rate authority as approved by FERC will continue to be complied with by Split Rock, thereby insuring that Split Rock's obligation to meet Great River Energy and MP energy requirements is not affected by this agreement.

MP agreed to retitle the agreement a power brokering agreement, rather than an administrative services agreement, and also agreed to modify the agreement to confirm that Split Rock will charge Rainy River the higher of fully-allocated costs or market prices for the services provided.

Further, MP agreed to coordinate with Split Rock and Rainy River to ensure that a periodic market survey be performed to ensure that costs of services reflect the higher of cost or market. This information will then be available for the DOC to review at its request.

MP argued that the potential transfer of the Kendall County agreement was not the subject of MP's current petition.

MP stated that discussions with the DOC have clarified that the issue regarding future potential transfer of the Kendall County agreement does not need to be addressed or resolved at this time in order to meet the DOC's recommendation for approval, as long as MP meets the DOC's other requirements relating to the agreement.

V. Commission Action

The Commission agrees with the DOC that the proposed power brokering agreement, modified as recommended by the DOC and agreed to by MP, is reasonable and in the public interest. The Commission will approve the agreement as modified to recognize it as a power brokering agreement and confirming specifically that charges will be at the higher of fully allocated costs or market prices with the retention of supporting records.

The agreement allows the marketing of the Kendall County unit to continue in the same manner as such services were previously provided by MPEX personnel, prior to their transfer to Split Rock. Further, the accounting procedures set forth in the agreement ensure that Split Rock will be appropriately billing Rainy River for these services and neither Great River Energy or MP will be billed for the services provided to Rainy River. Finally, the protections in place under Rainy River's market based authority, as approved by FERC, will continue to be complied with by Split Rock. This ensures that Split Rock's obligation to meet Great River Energy and MP energy requirements is not affected by this agreement.

The Commission recognizes and appreciates the concerns expressed by the DOC about the possible future transfer of the power purchase agreement from Rainy River to MP. The Commission agrees that the approval of the affiliated interest agreement is a separate matter and this Order does not address such a possible future transfer.

ORDER

1. The affiliated interest agreement between Rainy River and Split Rock, with the recommendations by the DOC, and agreed to by MP, to change costing and descriptive language (as discussed herein) is approved.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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